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USDOC FOR ITA (ISRALY ECHEGARAY)
TREASURY FOR IA (ALICE FAIBISHENKO, ANNA JEWEL)
TREASURY FOR OCC/IBF (SUSAN QUILL)
TREASURY FOR IBSMO (WILBUR MONROE, BILL FOSTER)
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NSC FOR RICHARD MILES, DAN FISK
SEC FOR OIA (SHAUNA STEELE)
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SUBJECT: CHALLENGES FACING MEXICO'S STOCK EXCHANGE

Summary and Introduction

11. (SBU) On October 29, 2007, the Mexican Stock Exchange (BMV) held its 18th annual convention, which centered on the need to "democratize" the stock market and to increase medium-sized companies, access to capital markets. Finance Secretary Agustin Carstens and Bank of Mexico Governor

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Guillermo Ortiz participated in the event, and pledged more competition in the stock market, the issuance of more initial public offerings (IPOs), the elimination of entry barriers, and the adoption of international standards by the BMV. President Calderon highlighted his administration's efforts to consolidate macroeconomic stability, as well as his commitment to fight organized crime and to support reforms of the judicial system, energy, labor, and telecommunications sectors, as well as deregulation to help Mexico become more competitive. End summary.

Modernizing the Mexican Stock Exchange

12. (U) Stock exchanges in developing countries have abandoned the organic-growth model to make way for a wave of mergers, acquisitions, and IPOs from the stock exchanges themselves. Resources obtained from these IPOs have been channeled to the construction of global stock exchanges. The Mexican Stock Exchange (BMV) does not want to be the exception. Following the successful mergers and the IPOs of the Montreal and Brazilian Stock Exchanges, the BMV's board decided to reorganize its structure and implement corporate governance

standards for an eventual IPO issuance. They also have understood the importance of developing products for more aggressive investors, such as hedge funds and private pension funds. Thanks to the reforms of the private pension funds' investment regime, the participation of these institutional investors has grown from 8% of GDP in 2000 to 21% of GDP in 2007. Currently, 37 million Mexicans are investing their pension funds in the stock market through private pension funds called Siefores. In view of this, the BMV has issued more derivatives, structured products, and new asset classes.

13. (U) BMV President Guillermo Prieto explained that the exchange's modernization strategy is based on four pillars: 1.) innovating by offering derivatives, futures, swaps, and very soon Mexico's version of real estate investment trusts (called FIBRAS); 2.) improving operations by updating technology; 3.) broadening ownership to increase transparency (Note: the BMV now has more independent members on its board and on its auditing, securities registration, and regulation committees than in the past.); and 4.) creating a larger social impact. The BMV's role as a facilitator in channeling resources to social welfare has been significant. From 2001 to date, the accumulated debt placed by the Federal Mortgage Corporation, the Private Sector Workers' National Housing Development Institute (Infonavit), and mortgage sofoles (non-bank banks) totals USD 7.7 billion. Around USD 4.6 billion of public works in states and municipalities have been financed through the BMV.

Democratization of the Mexican Stock Exchange

14. (U) All of the speakers attending the convention agreed that one of the most significant challenges for the sector

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was to "democratize" the BMV and facilitate medium-sized businesses' access to financing. Thanks to the new Securities Market Law approved in 2005, it is easier for medium-sized businesses to have access to financing through the stock market, provided they comply with basic corporate governance requirements. The BMV has also implemented a program to facilitate their progressive access. The sector understands that it has to work harder to promote the listing of more issuers and to achieve a deeper local capital market. As the Vice Chairman of the Mexican Financial Intermediaries Association said: "The Mexican secondary market will only strengthen to the extent that the primary market grows."

Regulation, Supervision and Competitiveness

15. (U) Guillermo Babatz, President of the National Banking and Securities Commission (CNBV), spoke about the modernization process that the securities law has undergone in recent years to incorporate international standards. Babatz noted that the challenge currently lay in implementing the law and regulations adequately to stimulate the sector's development. He pledged to strengthen sanctions against violations and to protect minority stockholders. The CNBV will continue cooperating with its counterparts in other countries regarding supervision. Babatz noted that Mexico should be prepared to face more aggressive competition worldwide by promoting the entry of more financial intermediaries in specific niches, and by reducing placement, operation, and regulatory costs. The CNBV announced it will reduce its fees for securities and debt issuance by 20% and 40%, respectively, beginning on January 1, 2008. Finally, Babatz called for a reduction in placement fees charged by brokers.

Use of FIBRAS To Boost Infrastructure

16. (U) BMV Deputy Director Alejandro Reynoso announced that Mexican Real Estate Investment Trusts (FIBRAS for the acronym in Spanish) were ready to be launched. Legislation allowing for FIBRAS was passed in 2003. He explained that authorities approved several tax benefits for FIBRAS, including the deferment of income and real estate acquisitions payments, no tax withholdings, and no tax for change of control. However, he also explained that there are some restrictions to prevent taxpayers using FIBRAS only for tax planning and tax evasion purposes. Recent changes to the pension law will create five different Siefores (private pension funds), which will be able to diversify their portfolios and risk levels depending on the age of the worker. Reynoso said that, ideally, Siefores and insurance funds should be able to invest in infrastructure projects during the construction stage -- that is, investing more with capital than with debt to give workers more value added on their investment. Fitch Ratings will assign a rating to the FIBRAS based on several factors, including their debt level, experience in the sector, and the value of the land in question.

Challenges Ahead

17. (U) For Bank of Mexico Governor Guillermo Ortiz, the financial markets' most significant challenges are: increasing savings, expanding access for households and SMEs, providing incentives to increase participation in debt and

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capital markets, and having the financial system play a greater role in promoting the country's productivity and economic growth. For the sector, it is necessary to foster the development of capital formation and strengthen the BMV, both economically and institutionally, so that it is able to compete globally. It should also eliminate obstacles and entry barriers for new issuers. To illustrate the growth potential of the BMV, Ortiz compared the number of listed companies on the exchange (156) against the number of companies listed on the Brazilian Stock Exchange (350). The number of companies registered with the Secretariat of Finance for tax purposes is 11,000. During the past year, Mexico only had five IPOs, whereas Brazil has had 60. He also said that the BMV's capitalization ratio was 47% against 60% of the Brazilian Stock Exchange's, not to mention the existing high level of concentration of the largest ten companies in the BMV, which represent 80% of the total market value.

18. (U) Finance Secretary Carstens noted that while the securities market helped make up for commercial banks' lack of lending after the 1994-95 economic crisis, it is now necessary to reevaluate the securities market's role. For Carstens, the securities market's primary role is not to satisfy the daily financial needs of businesses, but to provide capital to entrepreneurial and productive projects needed to stimulate job creation and economic welfare -- in other words, "to democratize the capital." Carstens considered that the size of the Mexican stock market does not correspond to the economy's size and potential. He called for more IPO's taking advantage of the existing macroeconomic stability and modern legal framework. He also urged the BMV to adopt international governance standards for the issuance IPOs.

Calderon Promises More Reforms

19. (U) During his presentation, President Calderon praised the BMV's performance, the consolidation of macroeconomic stability, and the consensus achieved among different political actors on the ISSSTE (the social security institute

for government workers), fiscal, and electoral reforms approved during his eleven months in power. He pledged to continue fighting organized crime and to support reforms of the judicial system, energy, labor, and telecommunications sectors, and a deregulation process to help Mexico become more competitive and attractive to investors. He added that the BMV should become an investment option, not only for large corporations, but also for businesses in need of credit or capitalization. In other economic issues, President Calderon highlighted the need to diversify exports to reduce Mexico's vulnerability to the performance of the U.S. economy. He also announced that in the coming year the government will channel 70% of its programmable spending to social programs, and 65% of the additional resources obtained from the recently approved fiscal reform to infrastructure projects.

Comment

¶10. (SBU) There has been a general call from various sectors, the public, politicians, and international organizations to take on Mexico's public and private monopolies. The BMV is no exception. There is an urgent need to break down resistance and reduce the concentration of conglomerates

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owned or controlled by powerful families to help SMEs go through the entire process of listing their assets and obtaining more capital. One of the sector's short-term goals would be implementing and taking advantage of modern regulations, the new securities law, which protects minority shareholders, as well as macroeconomic stability to stimulate the issuance of more IPOs, and to satisfy their need for capital and implement the productive projects that Mexico so badly needs. End comment.

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